IT 07-0024-GIL 06/19/2007 CREDITS – FOREIGN TAX

General Information Letter: Explanation of computation of "double taxed income" for Wisconsin.

June 19, 2007

Dear:

This is in response to your letter dated May 25, 2007. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www. tax.illinois.gov.

In your letter you have stated the following:

> We are in receipt of your notice which asks the above taxpayers to remit an additional $1,000.84 due to a recalculation of the Schedule CR included in their Illinois return. We have reviewed the revised Schedule CR (copy enclosed) and the accompanying materials regarding the Illinois Schedule CR Comparison Formulas for Individuals and disagree with your assessment.
>
> We are enclosing an IL-2848, Power of Attorney, signed by the taxpayers, so we might represent them in our discussions. Since this is a very technical issue, we request that someone from your legal department review our arguments.
>
> We believe the argument you are making revolves around the difference in taxability of pension and social security income between Illinois and Wisconsin. You are saying that since Illinois does not tax pension income, it should be added back to IL base income to arrive at the equivalent taxability in WI. We believe that the correct modification is to remove the pension income from the WI return to see if there is a change in the WI tax. If there is no change in the WI tax, then the income that is double taxed is the entire amount. This can be shown in two ways, and I have enclosed both of them with this correspondence.
>
> The first method is to simply subtract the pension and social security income from the WI return, as if WI allowed it as a deduction. As you can see from Method #1, the tax is only $121 different on WI from the return we filed. We believe Method #2 is perhaps the most compelling argument that your recalculation is incorrect. In Method #2 we have recomputed the tax return without including the taxpayer's pension and social security income but with all other data the same. Obviously, this produces an incorrect Federal return (Federal tax is understated) but the WI tax is only $4 different from the Method #1 computation and $125 less than the return we filed. Clearly, if a taxpayer actually had the income and deductions on this return, you would not have adjusted the Schedule CR for pension income because there was none. Thus, in this case, the Schedule CR produces the correct computation, $23,873. To argue that the addition of pension income to this example, should reduce the credit appears to violate your Publication 111 instructions which state:

> "An item of income is double-taxed only to the extent that both Illinois and the other state or taxing jurisdiction include it in income."
>
> The taxpayer is double-taxed on their WI gambling winnings; they are not double-taxed on their pension earnings (both states do not include this as income), yet adding pension earnings to Method #2 is reducing their credit. Under your computation, it would appear that Illinois is taxing the pension earnings.
>
> Please review these examples and if you concur that your deficiency notices was in error, adjust our client's tax return accordingly. If you feel that you can substantiate your assertion, we welcome your discussion.

Response

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601) provides, in part:

> The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.

The Department's regulation at 86 Ill. Adm. Code Section 100.2197(b)(4) provides that, in order to compute the "base income subject to tax by both such other state or states and by this State" (referred to as "double-taxed income"), a taxpayer should take into account only those items of income taxed by both states and should deduct only those expenditures for which both states allow a deduction. Section 100.2197(b)(4)(G) provides:

> Some states compute the tax liability of a nonresident by first computing the tax on all income of the nonresident from whatever source derived, and then multiplying the resulting amount by a percentage equal to instate sources of income divided by total sources of income or by allowing a credit based on the percentage of total income from sources outside the state. Other states determine the tax base of a nonresident by computing the tax base as if the person were a resident and multiplying the result by the percentage equal to in-state sources of income divided by total sources of income. The use of either of these methods of computing tax does not mean that income from all sources is included in double-taxed income. See Comptroller of the Treasury v. Hickey, 114 Md. App. 388, 689 A.2d 1316 (1997); Chin v. Director, Division of Taxation, 14 N.J. Tax 304 (T.C. N.J. 1994). When a state uses either of these methods of computation, double-taxed income shall be the base income of the taxpayer from all sources subject to tax in that state, as computed in accordance with the rest of this subsection (b)(4), multiplied by the percentage of income from sources in that state, as

> computed under that state's law; provided, however, that no compensation paid in Illinois under IITA Section 304(a)(2)(B) shall be treated as income from sources in that state in computing such percentage.

The provisions for computing income that is double-taxed by Wisconsin and Illinois in Publication 111, Illinois Schedule CR Comparison Formulas for Individuals, follow this provision. Because Illinois did not tax the state income tax refunds or pension or Social Security income of your clients, these items must be excluded from double-taxed income. The fact that Wisconsin did tax that income is proved by your examples, in which treating that income as exempt from Wisconsin taxation reduces your clients' Wisconsin liability. Accordingly, the adjustment made to the credit allowed for taxes they paid to Wisconsin is correct.

By the way, your Method #2 produces a different result than your Method #1 only because you failed to exclude state income tax refunds in Method #2.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax